

Realty Stock Review



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MARKET STRATEGY: REALTY STOCKS PICK UP A BIT AND A FEW ISSUES PEEK TO NEW HIGHS

Realty stocks are starting to show up in the lengthy new-high lists, and that shows some revival of interest in the group. The NAREIT Index of all REIT stocks moved up 1% in January, first upmove since last fall. We will begin carrying the NAREIT Index, maintained by the National Assn. of REITs, in the next issue to provide one more measuring rod.

The new high list proves that a good story backed by EPS/CFS gains still wins investor notice. The list has included the following during the past two weeks:

--**Federal Realty Trust**, a skilled shopping center renovator in the Northeast; cash flow will be up only modestly in 1986 as FRT completes two major renovations but big 1987 gains are seen.

--**Countrywide Mortgage Investments and Lomas Mortgage Corp.**, two new mortgage REITs off to fast starts in selling collateralized mortgage obligations, boosting EPS and returns.

--**Hovnanian Enterprises**, New Jersey and Florida homebuilder which reported Nov. quarter EPS up 126% on booming sales in the New Jersey market. Other strong homebuilders are **Centex**, **Lennar** and **Ryland Group**.

--**Lomas & Nettleton Financial**, nation's largest mortgage banker continuing to benefit from growing financial services.

--**Hotel Properties**, on news it bought 9.9% of **Hotel Investors** (also at a high) and would seek merger of the two lodgings REITs.

--**Standard Pacific Corp.**, California homebuilder which says it will consider converting to a master limited partnership similar to UDC-Universal (RSR, Sept. 27).

--**Integrated Resources** on strong rebound in syndication, mutual fund and insurance annuity sales.

--**General Development** on strong \$3.01/sh. EPS in 1985; **Clayton Homes**, fast growing mobile home maker.

--**Diversified Kaufman & Broad**, **Del E. Webb**, **Walt Disney**, and **Santa Fe So.**

The clear message: So many realty stocks have lagged this market move so far that any good story moves them. Herewith Ranking Reviews of some stocks with interesting potentials.

RANKING REVIEWS: VALUES PLUS INCOME ABOUT AMONG REITS AND PROPERTY OWNERS

HRE Properties, formerly Hubbard Real Estate Investments, rises to A Rank. HRE ended its advisory contract with a Merrill Lynch subsidiary Feb. 1

RANKING REVIEW ISSUE

Market Comment..... 1
Realty Stock Averages..... 4

COMPANY REVIEWS

CleveTrust Realty Inv.... 4
HRE Properties (Hubbard)... 1

JMB Realty Trust..... 4
Mortgage & Realty Tr.. 3
Property Trust of Amer. 2

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and became self-administered.

EPS/Dividends - A: HRE earned \$1.99/sh. from operations in its Oct. fiscal year, up 5%. Property sale gains added 2¢ in 1985, down sharply from 29¢ in 1984. Operating funds for distribution (cash flow) computed by HRE were \$2.51/sh., up 11.6%. Dividends rose 3.6% to \$2.28 annual rate, in line with the 3.3% annual growth the past five years. While growth is modest, it marks the first fruits of HRE's strategy adopted several years ago to divest most bond-type net leased properties in favor of multi-tenant properties deemed to have more growth potential.

Today 81% of assets are in properties owned or held in joint ventures, and another 4% are mortgages with equity participations. Only 10% are long-term fixed rate mortgages. Assets are now 50% offices (interests in seven offices with 973,000 sq. ft.); 36% retail (interests in three shopping centers and seven department stores with 1.09 mil. SF; and 14% service and distribution facilities. Retail properties, converted to multi-tenancy when W.T. Grant went bankrupt a decade ago, are clear winners and 99% leased; they generated 13¢ sh. percentage rents in 1985, up 23%. The Springfield, Mass. mall is being expanded 34% to 277,000 SF and most space is leased. In 1985 HRE bought a 49% interest in 225,000 SF Countryside Village, Clearwater, Fla. for \$18.5 mil., including a mortgage with a rising interest rate.

Offices are a modest disappointment and are 88% leased overall, above the national average. During 1985 HRE bought for \$4.6 mil. (plus \$13.4 mil. loaded to the partnership) a 50% interest in Civic Center Plaza Towers, 167,000 SF office in Santa Ana, Cal. (partner is Santa Anita Realty), which is now over 80% leased; and a \$5 mil. participating mortgage in a 61,000 SF office (98% leased) near Syracuse. HRE's offices in Southfield, Mich., Denver and Portland are over 95% leased, but occupancy remains in the 75% range in Charlotte and Houston.

Financial Measures - A: HRE debt of \$36.1 mil. is a low 0.26 times \$139.9 mil. equity, and even this leverage is high by HRE's historic norms. Only two

of HRE's 26 properties are mortgaged. HRE borrowed \$19.9 mil. at about 8.5% in 1985, mainly for the Countryside purchase, to maintain the 12% yield on a Treasury security it holds but which matures in July. And a \$6.7 mil. loan at 13% to the Santa Ana partnership comes due in 1986 and likely will be refinanced at lower rates. Liquidity is good and balance sheet strong.

Current value: We're often asked to estimate HRE's current value (HRE does not make a value estimate). Total \$75 mil. investment in offices is probably not far away from today's market value. Retail properties, being owned longer, are booked at only \$42 mil. or \$38.50/SF and likely are worth substantially more. If centers are worth \$60-\$75/SF, they then would add about \$4-\$6.75/sh. over the \$23.76/sh. net book value.

Exposure - B: HRE is somewhat exposed to office conditions in some overbuilt cities, although its properties are generally prime and stand up well to competition. Retail properties do very well. Dividend of \$2.28 is about 91% of operating cash flow and yields 9.7% at prices of \$23.50. Low leverage limits downside risk.

Property Trust of America (\$11.50-NASDAQ), holds A Rank although 1985 results haven't been announced yet. Based in El Paso, Tex. PTRAS is a small but growing REIT that owns a diversified portfolio of income properties in the Southwest and Mountain states.

EPS/Dividends - B: PTRAS' operating net cash flow likely was about \$1.05 per share in 1985; we expect a very modest gain in 1986 to about \$1.10 per share, with about 4% variance possible. PTRAS also hopes to sell two idle land parcels and an older apartment/shopping center complex for gains in the 40¢ range for 1986. Thus the \$1.20 current dividend should be covered from operating cash flow and capital gains. The portfolio changes should improve competitiveness and return of the portfolio. At current prices the shares yield about 10.4%.

Properties: About 55% of PTRAS's estimated \$1.10 per share net operating cash flow in 1986 is expected to come from retailing, vs. about 37% of revenues from retailing only two years ago.

PTRAS's major retail properties include six shopping centers with 537,000 sq. ft. of retail space, all but one in Denver or Colorado Springs. Occupancy is holding up well and expiring leases are being rolled over at 10%-20% rent increases; one center may be expanded.

Hotel and office holdings each generate about 13.5% of cash flow. One of PTRAS's most successful investments is its 50% partnership interest in the 338-room Holiday Inn on Fisherman's Wharf, San Francisco, giving PTRAS significant entree to this major tourist market. The hotel provided about 22% of cash flow in 1985 and its value is a significant portion of current value. A three-year guarantee of cash flow gains arising from a hotel addition (not owned by PTRAS) expired in October but PTRAS sees no significant cash flow change from this expiration. PTRAS and its partner are discussing buying the land beneath the hotel, which could make ultimate sale easier. PTRAS owns only one 67,500 sq. ft. office building, Crown Tower in San Antonio, making its exposure to office overbuilding relatively small. The building's largest tenant, an energy-related company, recently moved, leaving about 28% of space vacant; however PTRAS has already re-leased half this space at the same rent and is finding good interest from smaller tenants for the balance.

Financial Measures - A: PTRAS has excellent liquidity and low leverage, which should allow it to take advantage of purchase opportunities. PTRAS has about \$13 mil. cash and is considering several investments in the Southwest and other areas, where some distressed properties may become available at good prices. It has targeted entry into Phoenix, Tucson, Albuquerque, Salt Lake City, and Oklahoma City. Leverage is low with about \$13 mil. of debt being only 0.27 times shareholders' equity. Equity of \$48.5 mil. plus accumulated depreciation of \$7.5 mil. equals \$10.88 per share.

Current asset value. Management estimates current value of net assets is about \$16.50 per share. At current prices of about \$11.50 per share, PTRAS shares are selling at about a 30% discount to asset value.

Exposure - A: Acquisitions of several shopping centers in recent years gives PTRAS opportunity to benefit from retailing growth in this region, while some property sales have reduced exposure to offices in the Southwest. PTRAS's liquidity and conservative financing posture it ideally for an eventual real estate turnaround in the fast growing Southwest.

Mortgage & Realty Trust (NYSE--\$19.50) holds A Rank.

EPS/Dividends - A: MRT earned \$1.73 sh. from operations in its Sept. 1985 fiscal year, up 5%; property sales added 5¢ in both years. Operating income of 43¢ in the Dec. qtr. was level with the Sept. qtr. but down 9% from 1984; amortization of original issue discount on notes sold a year ago reduces EPS by about 2¢ per qtr. The \$1.80 regular dividend yields 9.2%. **Additional interest income.** MRT also reaped 31¢ sh. additional interest in the Dec. qtr. when four participating loans were repaid, and paid a special 12¢ dividend as partial distribution of that income. Owners of two properties securing participating loans also expect to sell their properties which, if completed, would give MRT another 19¢ additional income.

Assets: MRT held \$262 mil. invested assets at Dec. 31, up 19% in a year, divided 94.5% earning mortgages and 5.5% nonearning loans and foreclosures (a percentage level with Sept. and long-term averages). Mortgages are about 35% standing loans, 27% construction/development, 17% long-term amortizing; and 12.6% participating loans (which gave rise to the Dec. qtr. kicker income). MRT has moved into participating mortgages in the last two years and had \$47 mil. unfunded commitments at Dec. 31.

Financial Measures - A: Debt of \$144.5 mil. at Dec. 31 is 1.08 times equity of \$134.4 mil. or \$15.97/sh. net of 76¢ discount. Debt is 65% short-term floating rate (commercial paper and bank); 10% revolving credit; and 25% long-term fixed rate, which matches well with asset maturity. Liquidity is good.

Exposure - A: MRT has a long track record as a careful, conservative speciality mortgage lender. Participating loans give inflation protection.

CleveTrust Realty Investors falls to B Rank. We dislike changing ranking during a proxy contest (see below) but interest on new debt incurred to buy back stock nudges CTRIS below A Rank.

EPS/Dividends - B: CTRIS' Sept. 1985 earnings and net cash flow are obscured by three non-recurring or special items meriting special analysis: (1) Credit of 36¢ sh. from lowering the loss reserve; (2) Expenses of 52¢ for shareholder litigation, liquidation study, and subsequent share buyback; and (3) \$1.99 gain on sale of an Orlando apartment. Putting these together shows per share results for Sept. '85 year:

	EPS	CFS
Operating income/CFS..	\$0.89	\$1.33
Loss reserve credit...	0.36	0.36
Litigation expense....	(0.52)	(0.52)
Reported EPS/CFS....	0.73	1.17
Property sale gains...	1.99	1.99
Total EPS/CFS.....	\$2.72	\$3.16

Litigation resulted in CTRIS repurchasing 847,209 sh. from the former largest shareholder, Merchant Navy Pension Plan of England, for \$19/sh., paid half cash, half in 12% notes. Interest on the \$8.05 mil. note of 12¢ sh. put CTRIS operating EPS into 2¢ sh. loss in the Dec. qtr. and cut operating cash flow to 12¢, off 50%. CTRIS also lost interest income on the \$8.05 mil. cash.

Assets: Net invested assets of \$57.8 mil. at Sept. 30 are 65% direct ownership of property and 35% mortgages. Properties at cost are about 65% offices with 621,000 SF; 14% commercial including a St. Louis hotel and retail; and 20% apartments and other. Major offices are located in Tulsa, Dallas and the Denver area, where strong competition

for tenants has limited results. Interest income has risen as CTRIS invested in an Austin, Tex. shopping center convertible loan and extended purchase financing in Orlando.

Financial Measures - A: Debt of \$25.3 mil., adjusted for the share repurchase, is 0.65% of the \$38.8 mil. sum of shareholders' equity (\$28.65 mil. or \$14.35/sh.) and accumulated depreciation (\$10.15 mil. or \$5.09/sh.). Pro forma debt is 42% mortgages, 32% share repurchase note, and 26% bank debt.

Exposure - C: At the property level, CTRIS continues exposed to weak Southwestern office markets. Investor Robert Goodman of Los Angeles, now the largest holder with 8.5%, is pressing a proxy fight to elect four of nine trustees at the Feb. 18 annual meeting. With the buyback CTRIS puts its current asset value at about \$25/sh. not discounted for selling time or expenses; outcome of the proxy fight will determine what happens to that value.

JMB Realty Trust remains at B Rank for its Aug. 1985 fiscal year.

EPS/Dividends - B: JMBRS netted \$1.79 from operations, down 8%, due to lower interest on mortgages sold the prior year, offset in part by higher rentals on enclosed Sycamore Mall, Iowa City, acquired June 1985. Nov. qtr. EPS fell 16% to 41¢ sh., after 3¢ depreciation. JMBRS holds mainly land purchase leasebacks and wraparound mortgages.

Current value: JMBRS estimates current value at \$18.37/sh., down 5% from Aug. 1984 but 9% above cost-basis equity of \$16.02/sh. Reduction in value of a Houston apartment leaseback and deferred tax provisions hurt 1985 value.

COMPARATIVE REALTY STOCK GROUP AVERAGE 02/11/86

GROUP NUMBER & NAME	DIV	NON-DIV	TOTAL	SHARE (000)	BOOK VALUE	ANNUAL DIV	EARN ANN	LAST PRICE	-% CHANGE FROM JAN 21	FROM JAN 1	P/E RATIO	ANNUAL YIELD	% PR TO BK	RETURN ON BK	MARKET VAL(000)
1 PROPERTY REITS	36	6	42	5174	11.51	1.22	1.03	15.35	-0.0	1.1	14.9	8.0	33.3	8.9	3451.5
2 PROP & MTG COMB REITS	20	1	21	5055	13.05	1.60	1.86	15.83	1.1	1.4	8.5	10.1	21.3	14.2	1737.6
3 MORTGAGE REITS	14	1	15	5897	14.97	1.99	2.51	15.55	2.9	4.9	6.2	12.8	3.9	16.8	1390.7
4 PARTICIPATING MTG REITS	12	1	13	7899	12.48	1.24	1.13	13.35	0.1	2.8	11.8	9.3	7.0	9.0	1434.5
5 MAJOR HOMEBUILDERS	8	2	10	14248	11.55	0.35	1.75	18.84	11.8	10.2	10.8	1.8	63.0	15.2	2224.2
6 OTHER BLDG/DEVELOPERS	8	27	35	4808	6.09	0.15	0.31	9.09	5.6	5.7	29.8	1.6	49.2	5.0	1540.8
7 INCOME PROP BLDG/OWNR	13	9	22	5900	9.27	0.60	0.80	15.40	-0.8	-0.8	19.3	3.9	66.2	8.6	2563.8
8 MORTGAGE BANKER/FINANCE	9	6	15	9928	11.25	0.72	0.26	14.58	2.8	3.0	56.5	4.9	29.6	2.3	3386.9
9 DIVERSIFIED RLTY&HOLDING	12	9	21	19278	13.74	0.27	1.36	21.26	6.3	7.7	15.6	1.3	54.8	9.9	13743.1
10 RLTY SVCS/SYNDICATORS	4	2	6	7698	5.55	0.11	0.71	12.71	16.9	22.0	18.0	0.9	129.0	12.7	507.1
11 MANUFACTURED HOUSING	3	7	10	11764	5.45	0.12	0.23	10.00	8.7	8.5	43.5	1.2	83.5	4.2	1270.5
L LIQUIDATING COMPANIES	2	0	2	11349	3.84	1.29	1.42	4.50	12.5	5.9	NC	NC	17.3	NC	73.9
P PREFERRED STOCKS	3	0	3	2590	8.83	0.80	0.00	11.92	1.1	1.4	NC	NC	34.9	NC	89.3
OVERALL AVERAGE			215	7965	10.58	0.82	1.04	14.62	3.2	4.0	14.0	5.6	38.2	7.7	33413.9
DOW JONES INDUSTRIALS							90.78	1622.82	7.2	4.9	17.9	3.9			
STANDARD & POOR'S 500							15.45	215.92	4.9	2.2	14.0	3.8			
DOW JONES UTILITIES							17.60	178.65	4.6	2.2	10.2	7.9			